In the Supreme Court
OF THE
United States

OCTOBER TERM, 1943

No. 420

THE AMERICAN DISTILLING COMPANY,
Petitioner,

vs.

LOS ANGELES WAREHOUSE COMPANY,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the Supreme Court of the State of California
and
BRIEF IN SUPPORT THEREOF.

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PETITION FOR WRIT OF CERTIORARI
to the Supreme Court of the State of California.

To the Honorable Harlan Fiske Stone, Chief Justice of the United States and to the Associate Justices of the Supreme Court of the United States:

Petitioner, the American Distilling Company, respectfully prays that a writ of certiorari issue to review a decision of the Supreme Court of the State of California rendered on June 30, 1943 (R. 172) and which became final on the 30th day of July, 1943. This Court on September 20, 1943, extended the time to file this petition until October 15, 1943. (R. 173.)

SUMMARY AND SHORT STATEMENT OF THE MATTER INVOLVED.

Los Angeles Warehouse Company, hereinafter referred to as plaintiff, operates a United States bonded warehouse in Los Angeles. (R. 16.) The American Distilling Company, hereinafter referred to as defendant, operates a distillery in Sausalito, Northern California, and at the same place a United States bonded warehouse. (R. 16.) San Angelo Corporation, hereinafter referred to as San Angelo, is in the wholesale liquor business in Los Angeles and a warehouse customer of plaintiff. San Angelo ordered from defendant 25 drums of gin in bond to be delivered to plaintiff's bonded warehouse. (R. 17.) Pursuant to regulations issued under authority of federal statutes, plaintiff made application to the Department of Internal Revenue on a form known as 236 for a permit for the gin to be moved in bond by Evans Freight Lines, a highway motor carrier, from defendant's bonded warehouse to plaintiff's bonded warehouse. (R. 17.) A permit was so issued, and while in transit an accident occurred as a result of which the gin was destroyed by fire. (R. 19.)

The liquor was destroyed (removed from bond) under circumstances that the government became entitled to the tax. (R. 37, 19.) Liability for the payment of the tax is specifically covered by plaintiff's bond, furnished to qualify it to do business as an internal revenue bonded warehouse. (R. 7-10.) The Collector of Internal Revenue demanded payment of the tax from plaintiff, the receiving bonded warehouse. (R. 33.) No demand was made upon defendant. (R.

32-33.) Plaintiff paid the tax and brought this action against defendant for reimbursement. The trial Court rendered judgment in favor of plaintiff. This was affirmed by the District Court of Appeal. A hearing was granted by the State Supreme Court, which affirmed the judgment, the members of the Court, however, disagreeing radically on the grounds for the affirmance.

All essential facts are contained in an agreed statement. (R. 15.) It is stipulated that under the federal statutes and regulations distilled spirits in transit from one bonded warehouse to another are from the time of leaving the forwarding bonded warehouse deemed to be in the possession and custody of the receiving bonded warehouse and covered by its bond. (R. 17.)

Four of the justices of the State Supreme Court held that the internal revenue tax is a property tax, follows the property, is included as a part of the value of the goods, and on their accidental destruction while in bond the owner must pay the tax as an incident of ownership. (R. 165.) Three of the justices took definite issue with the theory that under the federal laws the tax on distilled spirits is a property tax and becomes a liability of the owner as an incident of ownership, and affirmed the judgment on the theory that under the federal laws and regulations the distiller remains primarily liable for the tax, notwithstanding the distilled spirits have passed into the custody of a bonded warehouse. The minority held that under the federal statutes and regulations, in the event of loss or destruction of distilled spirits, while in

the custody and covered by the bond of a bonded warehouse, the distiller, and not the bonded warehouse, is primarily liable and must bear the loss. (R. 169.)

THE QUESTIONS PRESENTED.

The questions presented are the following:

1. Is the internal revenue tax on distilled spirits a property tax for which the owner of the liquor in bond becomes personally responsible as an incident of ownership? Specifically, if distilled spirits are accidentally lost or destroyed while in bond (in the custody of a United States Internal Revenue bonded warehouse) under circumstances that the tax thereon becomes due to the government, is the owner of the liquor, by virtue of the fact of ownership, obligated to reimburse the bonded warehouse in whose custody the spirits were at the time of destruction and from which the government demanded and collected payment of the tax?

2. Is the distiller or the internal revenue bonded warehouse in possession primarily liable for the payment of the internal revenue tax on distilled spirits accidentally destroyed while in the custody, and covered by the bond, of the warehouse?

BASIS OF JURISDICTION OF THE SUPREME COURT OF THE UNITED STATES.

This case presents the issue of primary responsibility under federal statutes for the payment of the tax on distilled spirits, when such tax becomes due by reason of the accidental destruction of the spirits while in bond and in the custody of a United States bonded warehouse. The statutes and regulations involved are set forth in an appendix to this petition. The pleadings, the agreed statement of facts and the opinions of the Courts below, show that the federal questions presented by this petition were there raised and decided adversely to petitioner.

The appeal was first heard by the District Court of Appeal of the State of California. (R. 157.) That Court concluded that under the federal statutes primary and ultimate liability for the tax is at all times on the distiller and that collection is made from the bonded warehouse by the government as a matter of administrative convenience:

> "On this appeal defendant urges that under the provisions of the law, and the regulations made thereunder, when bonded liquor is damaged or destroyed in transit, the primary obligation is upon the receiving warehouse, and that the owner or distiller is not liable, except secondarily, for such tax. * * * From the above analysis it follows that as between the receiving warehouse and the distiller the ultimate and fundamental responsibility rests upon the distiller. * * * When plaintiff paid the tax, as it was required to do, it was not paying its debt, but the debt of defendant. Plaintiff's primary responsibility to the Govern-

ment for the tax was simply the result of Congress' attempt to facilitate the administration of the tax provisions and the collection of the tax." (R. 160, 164.)

The majority, four, of the State Supreme Court, interpreted the internal revenue statutes imposing taxes on distilled spirits as a property tax, a tax on the goods themselves, and construed payment to be an obligation incident to ownership of the liquor:

> "Defendant contends the Internal Revenue Code and regulations of the Department of Internal Revenue places primary (and inferentially ultimate) responsibility upon plaintiff for payment of the tax, and that to hold the distiller liable therefor would place upon the latter an impossibly burdensome contingent liability should gin distilled by it be destroyed after such gin had passed out of its control. It is not as the distiller, however, but rather as the *owner* of the gin that defendant here must reimburse plaintiff. The *owner* of the liquor lost it when it burned, and he must bear the loss of its total value, which, as we have seen, includes the tax which had attached. If title had passed from defendant company to its customer, then such loss, in the absence of some other controlling circumstance, would have been upon the customer rather than upon defendant. * * *.
>
> Inherently the tax is imposed on the *goods,* not on the manufacturer or the bailee. So far as persons dealing with the liquor are concerned the *tax follows the property as a necessarily included part of the value thereof* and, hence its actual payment being merely deferred, it becomes an

obligation of the owner, as an incident of ownership, payable on removal from bond." (Italics as in opinion.) (R. 167, 169.)

The minority, three, of the State Supreme Court disagreed with the majority, and stated the issue as follows:

"I concur in the result reached in the majority opinion but do not agree that the federal excise tax on distilled spirits is a property tax, that the tax follows the property 'as a necessarily included part of the value thereof,' or that it 'becomes an obligation of the owner, as an incident of ownership'. To employ property law concepts in the solution of problems like the present one can lead only to confusion.

The issue turns not upon who had title to the liquor that was destroyed, but upon whose tax liability was discharged by plaintiff when it paid the tax after the destruction of the liquor. * * * The determination of this issue rests upon the proper interpretation of the federal statutes and regulations with respect to the federal excise tax on distilled spirits. * * *

These provisions impose an excise tax on distilled spirits measured by the quantity distilled. (*United States v. Singer,* 82 U.S. (11 Wall.) 111, 121 (21 L. Ed. 49); see *Patton v. Brady,* 184 U.S. 608 (22 S.Ct. 493, 46 L.Ed. 713)). * * * If the tax were a property tax it would have to be apportioned among the states according to population. (U.S. Const. art. 1, sec. 2; see *Bromley v. McCaughn,* 280 U.S. 124 (50 S.Ct. 46, 74 L.Ed. 226); *Pollock v. Farmer's Loan & Trust Co.,* 157 U.S. 429 (15 S.Ct. 673, 39 L.Ed. 759).)" (R. 169-170.)

If the tax on distilled spirits is not a property tax, which the owner of the liquor is personally obligated to pay as an incident of ownership, then the decision of the majority of the State Supreme Court is erroneous. If, as between the distiller and the bonded warehouse having custody of the liquor, the primary liability under federal statutes and regulations for the payment of the tax on spirits destroyed while in the custody of the warehouse, is on the internal revenue bonded warehouse, then the decision of the minority is erroneous.

Federal questions are presented and this Court has jurisdiction to hear and grant this petition under section 237, Judicial Code (28 U.S.C.A. 344b).

REASONS RELIED ON FOR ALLOWANCE OF WRIT.

This case falls directly within subdivision (a), Section 5, Rule 38. "A State Court has decided a federal question of substance not theretofore determined by this Court." This Court has not heretofore had occasion to determine the questions presented by this petition, and they come before it as matters of first impression.

Majority opinion.

No Court, so far as we have been able to ascertain, has heretofore construed the internal revenue tax on distilled spirits to be a property tax, or a tax which the owner of the liquor is personally obligated to pay as an incident of ownership. No authority for this construction is cited in the opinion.

The minority criticism, that if the tax on distilled spirits were a property tax it would be a direct tax and levied in violation of article 1, section 2 of the Constitution, is sound.

Bromley v. McCaughn, 280 U.S. 124, 74 L. Ed. 226;

Pollock v. Farmer's Loan & Trust Co., 157 U.S. 429, 39 L. Ed. 759;

Dawson v. Kentucky Distillery & Warehouse Co., 255 U.S. 288, 65 L. Ed. 638.

There is nothing in the federal statutes or regulations that in the slightest degree implies a personal liability for the payment of the tax on the owner of the liquor in bond. Title is vested in the owner subject to the lien of the government for the payment of the tax. Possession can only be acquired by payment, but there is no personal obligation or liability on the owner.

The assumption that the tax is included as a part of the value of the liquor in bond, and that on its destruction the owner's loss is equivalent to the value of the liquor tax paid, is unsound. Likewise, is the deduction from this premise that the owner must reimburse the bonded warehouse in possession for the amount of the tax, on the theory that "if the subject of bailment perishes or is lost, or is destroyed or damaged by accident, without any fault on the part of the bailee, the loss must fall on the bailor". The opinion draws no distinction between the rights and liabilities of the owner of liquor in bond (in the custody of an internal revenue bonded warehouse and subject to tax) and

the owner of tax paid liquor on deposit in an ordinary warehouse. The rights and liabilities of the owner, as well as the obligations and duties assumed by the warehouse, are fundamentally different in the two cases. The bonded warehouse has assumed certain obligations specifically covered by its bond to the government, as a condition to the privilege of operating as such. One of these obligations is to pay the tax if the liquor is withdrawn from bond by loss or destruction, under circumstances that the statutes do not provide for the remission of the tax.

The payment of the tax is deferred while the liquor is in bond. The owner cannot obtain possession without payment of the tax. It is, however, quite a different matter to be obliged to pay the tax without getting the liquor. If the majority opinion is correct, any one who purchases and owns liquor in bond faces a personal liability to pay the tax in the event of its removal from bond by accidental loss or destruction. It would be extremely hazardous to own liquor in bond. The amount of the tax is several times the intrinsic value of the liquor itself. If in this particular case title had passed to San Angelo (if, for example, the contract between San Angelo and defendant had provided for delivery f.o.b. defendant's warehouse) then San Angelo as the legal owner, would have been liable to plaintiff for the tax. "If title had passed from defendant company to its customer, then such loss, in the absence of some other controlling circumstance, would have been upon the customer rather than upon defendant". (R. 168.) The fact that the defendant

happened to be the distiller and also owner of the forwarding warehouse is wholly coincidental and plays no part whatsoever in the majority opinion. "It is not as the distiller, however, but rather as the *owner* of the gin that defendant here must reimburse plaintiff". (R. 167.)

Although the owner has no right of access to the liquor or to watch or guard it while it is in bond, and possession and custody are exclusively vested in the licensed bonded warehouse, the owner would nevertheless be responsible for the tax on the liquor, where lost or destroyed under circumstances that negligence on the part of the warehouseman could not be established. On the other hand, the warehouseman, who has qualified to serve as the custodian of the liquor on behalf of the government while it remains in bond, and incidentally is entitled to charge the public for this accommodation, can look to the owner for reimbursement in the event of its accidental loss or destruction while in his possession.

The liquor tax is not a property tax, but an excise tax.

Patton v. Brady, 184 U.S. 608, 46 L. Ed. 713, 717-719;

United States v. Singer, 82 U.S. 111, 121, 21 L. Ed. 49, 57.

The payment of the tax is secured to the government by a personal obligation on the part of the manufacturer covered by the manufacturer's bond, by a personal obligation on the part of the internal revenue

bonded warehouse in possession covered by the warehouseman's bond, and by a lien on the liquor itself. The majority conclusion that ownership of the liquor in bond entails a personal liability for the tax is fallacious. It is important that this issue be determined by this Honorable Court.

Minority opinion.

The minority concludes that under the federal statutes and regulations, the liability of the internal revenue bonded warehouse, to pay the tax on liquor lost or destroyed while in its custody, is ancillary to and by way of security of the distiller's obligation. (R. 17*l*) It will be observed that no authority or precedent is cited for this conclusion. It purports to be an original deduction from an analysis of the statutes.

As a matter of fact, the determination is in conflict with the decision of the Treasury Department, charged with the enforcement of law, and two decisions of the United States Circuit Court of Appeals.

Treasury Decision No. 20,290 (see appendix) was issued in answer to the inquiry whether any liability whatsoever rests under a distiller's bond after the distilled spirits have been deposited in a bonded warehouse and are covered by a warehousing bond. The decision was that, while liability remains under a distiller's bond, resort should only be had thereto after the warehousing bond has been exhausted. This ruling necessarily implies that primary responsibility rests on the bonded warehouse for loss that is covered by

its bond. This decision was rendered in 1899 and has ever since governed the practice of the department.

In *United States v. Guest,* 143 Fed. 456, the Circuit Court of Appeals of the Fourth Circuit definitely held that the sureties on the distiller's bond are secondarily liable and those on the warehouseman's bond primarily liable, in the event of a tax liability covered by the warehousing bond. The Court held that *manifestly* primary responsibility rests under the warehouse bond and the sureties on the distiller's bond, "if at all, are only secondarily liable."

In *United States v. National Surety Company of Kansas City,* 122 Fed. 904, the Circuit Court of Appeals of the Sixth Circuit cites and approves Treasury Decision 20,290, that the warehousing bond must be exhausted before resort is had to the distiller's bond.

The minority decision would make the distiller primarily liable for the tax on all distilled spirits manufactured and sold in bond. Having no knowledge of the ownership or location of spirits once sold, no control or check on the place where stored or the means of transportation employed, the distiller would never know from what corner of the country demands might come for payment of taxes on liquor for which, when sold, it had received the intrinsic or in bond price.[1] If such were the law, the only safe manner

[1]Such was the basis of the sale in this case. The selling price was $.28 per proof gallon delivered Los Angeles. (R. 18.) The tax was then $2.25 per gallon, approximately eight times the selling price. The tax has since been increased to $6.00 per gallon, approximately twenty-eight times the selling price in this case.

in which a distiller could operate would be to pay the tax in all instances and sell the liquor tax paid. This, however, would frustrate the very purpose for which the bonded warehouses were created. This question is also one that should be decided by this Honorable Court.

PRAYER.

Wherefore, petitioner prays that a writ of certiorari be issued out of and under the seal of this Honorable Court directed to the Supreme Court of the State of California, commanding that Court to certify and send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and of all proceedings in the case entitled Los Angeles Warehouse Company, Plaintiff and Respondent, v. The American Distilling Company, Defendant and Appellant, and being No. 12066 of the records of said Court, to the end that said cause may be reviewed and determined by this Honorable Court as provided by the statutes of the United States, and for such other and further relief as may be proper.

Dated, San Francisco, California,
October 4, 1943.

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